STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BROOKLYN NAVY YARD COGENERATION PARTNERS, L.P.	:	DETERMINATION DTA NO. 819110
for Redetermination of a Deficiency or for Refund of Corporation Tax under Article 9 of the Tax Law for the Period December 1, 1996 through November 30, 1999.	:	

Petitioner, Brooklyn Navy Yard Cogeneration Partners, L.P., 181 01 Von Karmen Avenue, #1700, Irvine, California 92612, filed a petition for redetermination of a deficiency or for refund of corporation tax under Article 9 of the Tax Law for the period December 1, 1996 through November 30, 1999.

A hearing was commenced before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 22, 2003 at 10:30 A.M. and was continued to and concluded on May 23, 2003 with all briefs to be submitted by March 12, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Morrison & Foerster LLP (Paul H. Frankel, Craig B. Fields and Roberta Moseley Nero, Esqs., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Kathleen D. O'Connell, Esq., of counsel).

ISSUES

I. Whether a rational basis existed for the issuance of the notices of deficiency at issue herein.

II. If so, whether the Division of Taxation ("Division") properly determined that sales of electricity and gas by petitioner to Consolidated Edison ("Con Ed") did not meet the statutory requirements of the exemption from the tax on importation of gas services as provided in Tax Law § 189 (former [6]) .

III. Whether the denial by the Division of petitioner's claim to the exemption in Tax Law § 189(former [6]) violates the Due Process Clause and the Commerce Clause of the United States Constitution.

FINDINGS OF FACT

In its brief filed on September 29, 2003, petitioner submitted 72 proposed findings of fact,[1] each of which has been substantially incorporated into the following Findings of Fact except for:

a. Certain portions of proposed findings of fact "5", "17", "22", "49", "66" and "71" which set forth qualifications and educational background of witnesses deemed superfluous;

b. The last sentence of proposed finding of fact "20" and the third sentence of proposed finding of fact "21" are rejected as not being supported by the record herein;

c. Proposed finding of fact "28" is rejected as not being supported by the record;

d. The first sentence of proposed finding of fact "29" is rejected as not being supported by the record;

e. The first sentence of proposed finding of fact "44" and proposed findings of fact "56" and "57" are rejected as being conclusory in nature;

[1] In its reply brief filed on March 12, 2004, petitioner sought to amend its proposed findings of fact "19" through "21". Accordingly, the amended proposed findings of fact "19" through "21" were considered to have replaced the original proposed findings of fact.

f. Portions of proposed finding of fact "68" have been summarized in the following Findings of Fact; however, some portions, most notably the quotation from Professor Pomp's written opinion, have been rejected as being superfluous; and

g. Proposed findings of fact "70" and "71" are in the nature of legal argument and are, therefore, rejected as not proper findings of fact.

In its brief filed on January 7, 2004, the Division submitted 24 proposed findings of fact, each of which has been substantially incorporated into the following Findings of Fact except for proposed finding of fact "9" which is rejected as not being supported by the record and proposed finding of fact "23" which is rejected as irrelevant inasmuch as petitioner's claimed exemption for sales to the Brooklyn Navy Development Corporation and Red Hook were not disallowed by the Division.

1. Brooklyn Navy Yard Cogeneration Partners, LP (hereinafter "BNYCP" or "petitioner") is a partnership that designed, built, owns and operates the Brooklyn Navy Yard Facility, a co-generation facility which produces electricity and steam, located in the Brooklyn Navy Yard. The Brooklyn Navy Yard is an area on the waterfront in Brooklyn that was formerly a military installation and is owned and operated by the Brooklyn Navy Yard Development Corporation ("BNYDC"). Petitioner began commercial operations on November 1, 1996. For the period at issue herein, December 1, 1996 through November 30, 1999, the facility was used to generate electricity and steam. Conventional generation of electricity produces both thermal energy (e.g., steam) and electricity, but wastes the thermal energy produced into the atmosphere. Cogeneration also generates both thermal energy and electricity, but captures some of the thermal energy which is otherwise wasted into the atmosphere in conventional production.

The process of cogeneration begins with a fuel source. Petitioner's primary fuel source is natural gas imported from Canada and the Gulf of Mexico (fuel oil is used as a backup to the natural gas supply and may be utilized approximately 19 days per year). Petitioner has separate contracts with the sellers of the natural gas and those that deliver the natural gas to the facility. At the facility, the natural gas is put into a gas turbine and electricity and hot gasses are produced.

2. The electricity produced at petitioner's facility is sold to Con Ed and BNYDC. Con Ed sells the electricity which it purchases from petitioner to its customers and BNYDC also sells the electricity which it purchases from petitioner to its customers, its tenants.

3. The hot gasses produced at the facility during the production of the electricity are put into a heat recovery steam generator. This process runs the hot gasses through cold water which generates steam. Some of this steam is sold by petitioner to Con Ed, BNYDC and the Red Hook Water Pollution Control Plant ("Red Hook"). Some of the steam is put into a steam turbine which produces more electricity which petitioner sells to Con Ed and BNYDC and steam which it sells to Con Ed, BNYDC and Red Hook.

4. In 1978, Congress passed the Public Utilities Regulatory Policies Act ("PURPA") which was enacted in response to the energy crisis during the Carter administration in 1977. PURPA was part of an overall policy initiative and legislative package aimed at reducing our reliance on foreign fossil fuels.

5. As relevant to the current matter, PURPA established a term to describe a type of facility known as a Qualifying Facility ("QF") that would produce energy in a more efficient manner than it was historically produced by traditional regulated utilities. In return for being more efficient, a Qualifying Facility would receive certain benefits: (1) electric utilities (for

example, Con Ed) are required to purchase electricity from Qualifying Facilities at their avoided costs;[2] (2) electric utilities are required to sell backup power to Qualifying Facilities at nondiscriminatory rates; and (3) Qualifying Facilities are subject to less stringent Federal and state regulation than traditional utilities.

6. In order to qualify as a Qualifying Facility under PURPA, a facility must: (1) not be owned more than 50% by a regulated utility; (2) satisfy certain operating standards; and (3) satisfy certain efficiency standards. In order to qualify as a Qualifying Facility under PURPA, at least 5% of a facility's total energy output (electricity plus thermal output) must be "useful thermal output" (a term which is defined in the regulations of the Federal Energy Regulatory Commission as thermal output used in an industrial commercial property).

7. Margaret A. Moore, a partner in the law firm of VanNess Feldman in Washington, D.C., represented petitioner with respect to its application with FERC to qualify as a Qualifying Facility. Prior to joining VanNess Feldman in 1985, Ms. Moore was employed from 1982 through 1985 by FERC. Since joining VanNess Feldman, she has been involved in thousands of matters concerning energy regulation before FERC. Ms. Moore represented qualifying facilities and other independent power producers in obtaining their regulatory certifications and acting as special regulatory counsel for those projects during financing, negotiating or reviewing project documents such as power sales agreements and steam sales agreements. Ms. Moore was qualified as an expert in the field of Federal energy regulation.

8. On August 16, 1995, petitioner filed an application with FERC for certification as a Qualifying Facility. This application was completed on October 19, 1995. By order issued

---

[2] Avoided costs are the equivalent of a regulated utility's cost of producing its own power or purchasing its power from another source. In New York State, avoided costs were estimated by the Public Service Commission.

January 17, 1996, FERC denied the certification. The order stated that while the facility satisfied FERC's operating and efficiency standards, it did not satisfy the ownership criteria set forth in 18 CFR 292.206(b) which required that no more than 50% of the equity interest in a Qualifying Facility be held, directly or indirectly through subsidiaries, by electric utilities and/or electric utility holding companies.

Thereafter, the partnership agreement was amended to address this issue and petitioner filed a self-certification within a few weeks of the issuance of the January 17, 1996 order of FERC. By order dated April 9, 1997, FERC granted petitioner's application for certification as a Qualifying Facility. This order, in granting petitioner's application for certification as a QF noted: "Under 18 CFR. 292.203(b), a qualifying topping-cycle cogeneration facility [which FERC found petitioner to be within the meaning of 18 CFR 292.202(d)] must meet the operating and efficiency standards specified in 18 CFR 292.205 and the ownership criteria in 18 CFR 292.206."

The original application contained more usage for Red Hook and did not include uses of the steam and electricity sold to Con Ed. The second application more accurately reflected the steam usage at the time that its operations began which was different from what petitioner had envisioned when it had submitted its original application two years prior.

9. In its petition, in paragraph "10" thereof, petitioner alleged: "The Facility is approved by the Federal Energy Regulatory Commission to operate as a Qualified Facility as such term is defined in section 201 of the Public Utility Regulatory Policies Act of 1978 (Public Law 95-617)." In both its answer and its amended answer, in paragraphs "2" thereof, the Division admitted this allegation.

In its brief, however, the Division asserts that based upon the order of FERC dated April 9, 1997, petitioner was not a Qualifying Facility prior to April 9, 1997 and, therefore, even if otherwise entitled to the exemption provided in Tax Law § 189(6), petitioner was not a Qualifying Facility entitled to claim such exemption until April 9, 1997.

10. Con Ed entered into an Energy Sales Agreement with petitioner on October 31, 1996. The agreement was executed on behalf of Con Ed by William A. Harkins who was employed by Con Ed for 33 years. Mr. Harkins's last position with Con Ed was as vice-president responsible for energy management and planning. In that position, Mr. Harkins was responsible for purchasing all the electric energy that Con Ed required. As such, he entered into contracts with utilities and independent power producers and purchased electricity from the marketplace for Con Ed's customers. Mr. Harkins also purchased gas for Con Ed and was responsible for planning Con Ed's electric, gas and steam systems.

Con Ed entered into a number of agreements to purchase power from independent power producers because it was required to do so by PURPA and by the manner in which PURPA was implemented by the New York State Public Service Commission.

11. Con Ed thought that agreements with Qualifying Facilities would lead to higher costs to its customers and took affirmative actions to avoid having to enter into these contracts, including objecting to a facility being given Qualifying Facility status. Con Ed originally objected to petitioner's request for Qualifying Facility status. Con Ed's objection to petitioner's request for Qualifying Facility status was not based upon any assertion that Con Ed would not be a thermal energy host. William A. Harkins indicated that Con Ed was a thermal energy host of petitioner and that Con Ed's being a thermal energy host allows petitioner's facility to qualify as a Qualifying Facility.

12. During the period at issue, petitioner filed with Con Ed on an annual basis a Qualifying Facility Monitoring Report demonstrating that the facility continued to meet the required ownership, operating and efficiency standards to qualify as a Qualifying Facility. Con Ed required petitioner to file these reports.

13. For each of the calendar years 1997, 1998 and 1999, petitioner listed Con Ed and BNYDC on its Qualifying Facility Monitoring Report as purchasers of the facility's useful thermal energy. As functions of the useful thermal energy, petitioner listed space and water heating, space cooling and process. The reports also state that BNYDC distributes the steam it receives to its tenants for heating buildings and that Con Ed distributes the steam it receives to its customers, but that petitioner was unsure of the exact process uses to which it was put.

14. Con Ed used the electricity and steam that it purchased from petitioner as part of its electric and steam systems which supply electricity and steam to its customers. The Con Ed steam system supplies steam, through pipes and transmission and distribution systems, to buildings in Manhattan from the lower part of Manhattan to 96th Street. During the period at issue, Con Ed was the only utility in New York State which distributed steam to multiple energy consumers. One of the facilities that supplies the steam for this system is Con Ed's Hudson Avenue Plant which supplies steam to the system through a tunnel.

15. For the period at issue, petitioner timely filed all of its tax on importation of gas services returns (forms CT-189) and claimed a 100% exemption for cogenerators for all purchases of gas service used to generate electricity and steam sold to Con Ed, BNYDC and Red Hook. This exemption was claimed based upon petitioner's position that all purchases of gas services used to generate electricity and steam supplied to Con Ed, BNYDC and Red Hook were exempt under Tax Law § 189(former [6]).

16. The Division conducted a field audit of petitioner's gas importation tax liability which commenced in September 1999. The audit was supervised by Laurence Albert, Tax Auditor III, who appeared and testified on behalf of the Division at the hearing. It was determined that most of the steam and electricity produced by petitioner was sold to Con Ed; the rest was sold to Red Hook and BNYDC.

The audit team made a decision to concentrate its resources on examining petitioner's sales of steam and electricity to Con Ed and not to examine the transactions between petitioner and Red Hook and BNYDC because those transactions were minimal when compared to the sales to Con Ed (Mr. Albert estimated that at least 90% of petitioner's sales of electricity and steam were made to Con Ed). Such conservation of audit resources is common audit practice. Accordingly, those portions of the exemption claimed by petitioner for its sales to Red Hook and BNYDC were not disallowed by the Division.

The audit team determined the amount of fuel gas burned by petitioner to produce the electricity and steam sold to Con Ed. Petitioner's representative during the audit, Robert Agnello, was advised by the auditors that the question of whether petitioner qualified for the claimed exemption would be referred to the Division's Office of Counsel. Subsequently, Mr. Albert was directed to issue a Notice of Deficiency to petitioner which asserted a deficiency of tax arising from a disallowance of the claimed exemption under Tax Law § 189(former[6]) for natural gas sold to petitioner and burned to produce steam and electricity. In issuing the Notice of Deficiency, Mr. Albert did not analyze the statutory construction of Tax Law § 189(former[6]). While Mr. Albert was unable to recall who informed him that petitioner did not qualify for the exemption, he indicated that it was someone from the Division's Transaction and Transfer Tax Bureau (TTTB). No written instructions were given to Mr. Albert; he did not have

any notes of any discussion; and no legal explanation was provided. Mr. Albert did not know the date of the conversation with the personnel from TTTB.

Mr. Albert did not analyze whether Con Ed was a thermal host or whether Con Ed was located at or near the cogeneration site. He did not know the location where title to the steam or electricity transferred from petitioner to Con Ed. Mr. Albert could not recall whether the sole factor in the determination to disallow the exemption was Con Ed's resale of the steam and electricity or if there were other factors in the determination.

17. By correspondence dated May 14, 2002, the Division provided petitioner with a Consent to Field Audit Adjustments showing the Division's proposed disallowance of the exemption for natural gas used to produce steam and electricity sold to Con Ed. The disallowance resulted in total additional tax due in the amount of $5,510,571.88.

18. On May 28, 2002, the Division issued two notices of deficiency to petitioner for the period December 1, 1996 through November 30, 1999. The first notice asserted additional tax on importation of gas services, pursuant to Tax Law § 189, in the amount of $4,709,890.50, plus interest for a total amount due of $6,228,836.30. The other notice asserted a deficiency of the temporary metropolitan transportation tax surcharge, pursuant to Tax Law § 189-a,[3] in the amount of $800,681.38, plus interest, for a total amount due of $1,058.902.13.

19. Petitioner filed a petition in this matter disagreeing with the Division's denial of the exemption from tax on all purchases of gas services used to generate electricity and steam supplied to Con Ed and also disagreeing with the Division's calculations. At the close of the hearing, the record was left open for the Division to submit a letter expressing its agreement with

[3] Since, pursuant to Tax Law § 189-a(2), all of the provisions of Article 9 of the Tax Law applicable to Tax Law § 189 were made applicable to the surcharge imposed by Tax Law § 189-a, all references to Tax Law § 189 and the exemptions thereunder shall, unless specifically noted otherwise, be applicable to Tax Law § 189-a as well.

petitioner's calculations as set forth in petitioner's Exhibit "2" or its disagreement together with an explanation. By letter dated September 8, 2003, the Division stated as follows:

> This will confirm that the Division does not dispute that Petitioner's Exhibit "2" in evidence in the above referenced matter reflects the appropriate rate of tax for the years 1998 and 1999. The Laws of 2000, Chapter 63, pt. Y, § 43 provided a tax reduction credit under § 189 of the Tax Law, retroactive to October 1, 1998. The credit effectively reduced the rate of § 189 tax from 4.25% to 4%. Petitioner's Exhibit "2" accurately reflects this change in the tax rate.

Petitioner's Exhibit "2" provides as follows:

Period ended	Taxable Consideration	Actual Tax Rate	Gas Import Tax	MTA Surch	MTA Tax	Total Tax	Total Assessed Tax	Over Assessmt
Nov 98	$5,902,321.28	4%	$236,092.85	0.68 %	$40,135.78	$276,228.64	$293,492.93	$17,264.29
Feb 99	$11,520,257	4%	$460,810.28	0.68 %	$78,337.75	$539,148.03	$572,844.78	$33,696.75
May 99	$6,912,510	4%	$276,500.40	0.68 %	$47,005.07	$323,505.47	$343,724.56	$20,219.09
Aug 99	$9,180,977	4%	$367,239.08	0.68 %	$62,430.64	$429,669.72	$456,524.08	$26,854.36
Nov 99	$8,381,986	4%	$335,279.44	0.68 %	$56,997.50	$392,276.94	$416,794.25	$24,517.31
			$1,675,922.05		$284,906.75	$1,960,828.80	$2,083,380.60	$122,551.80

20. As previously noted, the Division, in computing the deficiencies of tax as asserted in the notices of deficiency, allowed an exemption for purchases of gas services used to generate steam and electricity supplied to Red Hook and BNYDC pursuant to Tax Law § 189(former[6]), but not for purchases of gas services used to generate steam and electricity supplied to Con Ed.

21. The Division, in its answer[4] to the petition, affirmatively stated, among other things, that the electricity supplied by petitioner was not used by Con Ed within the meaning of Tax Law § 189 and that sales of electricity or steam to an entity which resells such electricity or steam to the ultimate consumer do not fall within the exemption provided by Tax Law § 189(6). The Division denied that Con Ed was a thermal energy host, asserted that it lacked knowledge or information sufficient to form a belief as to whether BNYDC was a thermal energy host located at or near the facility for the periods at issue and admitted that Red Hook was a thermal energy host located at or near the facility.

22. Con Ed owns a steam and electric generating facility adjacent to the Brooklyn Navy yard site owned by BNYDC. The facility is known as its Hudson Avenue Plant. The steam and electricity sold by petitioner to Con Ed is delivered to Con Ed's Hudson Avenue Plant.

23. Petitioner's facility is located within 2,000 feet of Con Ed's Hudson Avenue Plant if the distance is measured directly.

24. Steam leaves petitioner's Brooklyn Navy Yard facility and travels above ground to Con Ed's Hudson Avenue Plant, with ownership of the steam transferring at a metering station just past the fence separating Con Ed's property from the property of BNYDC. Following the steam line from petitioner's facility to the Hudson Avenue Plant results in a measurement of 3,250 feet.

25. Electricity travels from the facility, mostly underground, to the substation at the Hudson Avenue Plant. Following the electricity from petitioner's Brooklyn Navy Yard facility to the Hudson Avenue Plant results in a measurement of 2,950 feet.

---

[4] The Division's answer was filed on November 21, 2002 and an amended answer was filed on December 5, 2002. All references to the Division's answer shall, therefore, refer to the amended answer.

26. Frank W. Radigan appeared at the hearing and testified on petitioner's behalf. He is the principal and founder of the Hudson River Energy Group located in Albany, New York. The Hudson River Energy Group provides consulting services to the gas, electric and water industries, primarily in the fields of rates, utility economics and power supply planning. Prior to his association with the Hudson River Energy Group, Mr. Radigan was employed by the Public Service Commission for 15 years and was the lead engineer on major utility rate proceedings. He oversaw the gas, steam and electric rate cases and was on a team that was specifically assigned to handle all PURPA matters relating to qualifying facilities, including the implementation of regulations. Mr. Radigan holds a chemical engineering degree from Clarkson University and a Certificate of Regulatory Economics from SUNY Albany. Mr. Radigan was qualified as an expert in New York State energy regulation.

Mr. Radigan was familiar with the term "thermal energy host" and indicated that it means the recipient of the useful thermal output as defined under PURPA. He indicated that a regulated utility can be a thermal host. In his opinion, Con Ed, BNYDC and Red Hook were thermal energy hosts of petitioner.

27. Mr. Radigan stated that if a facility was going to be exempt from regulation under the Public Service Law, it was required to distribute its product to users that were "at or near" the facility. He explained that "at or near" is not a statutorily defined term and, because of that, the Public Service Commission has ruled on this issue on a case by case basis.

28. Mr. Radigan was not aware of any rulings of the Public Service Commission where a distance of less than one mile was not considered to be "at or near" a facility. In Mr. Radigan's opinion as an expert in New York State energy regulation, Con Ed's Hudson Avenue Plant and

petitioner's Brooklyn Navy Yard facility are the "exact definition of at or near" and are "just a throw over the fence."

29. Margaret A. Moore, who was qualified at the hearing as an expert in the field of Federal energy regulation (***see***, Finding of Fact "7"), explained that under FERC rules, the term "same site" is used regarding the aggregation of capacity of facilities and that FERC includes facilities as being on the same site if they are within one mile of each other. In her opinion, petitioner's facility and Con Ed's Hudson Avenue Plant would be considered to be located at the same site under the rules of FERC.

30. When asked during cross examination whether he or his auditor made a determination as to whether Con Ed's Hudson Avenue Plant was located at or near petitioner's facility at the Brooklyn Navy Yard, the audit supervisor, Laurence Albert, Tax Auditor III, replied that "I don't think we ever questioned that issue."

31. William A. Harkins who executed the Energy Sales Agreement between Con Ed and petitioner (***see,*** Finding of Fact "10") and who was employed by Con Ed for 33 years (the last 12 of which he served as Con Ed's vice president in charge of energy management and planning) was familiar with the term "at or near" the project site and was familiar with the location of both petitioner's Brooklyn Navy Yard facility and Con Ed's Hudson Avenue Plant. Mr. Harkins stated that petitioner's facility was located "very close" to the Hudson Avenue Plant and was "in the backyard" of the Hudson Avenue Plant. Mr. Harkins indicated that he was familiar with the term "thermal host." According to Mr. Harkins, a cogeneration facility typically produces electricity and steam. A "thermal host" is an entity that is located in close proximity to a cogeneration facility and which has the ability to use the thermal output (the steam) or some of the thermal output of that cogeneration facility.

32. In order to qualify as a Qualifying Facility ("QF") under PURPA, at least 5% of the facility's thermal output must be "useful thermal output."

Christopher Trabold, petitioner's Executive Director, indicated that all cogeneration facilities have thermal hosts and that Con Ed was the single largest thermal energy host of petitioner's facility; BNYDC and Red Hook were also thermal energy hosts of the facility.

If Con Ed was not a thermal host of petitioner, then petitioner could not have included its sales of steam to Con Ed in its calculations and petitioner would not, therefore, have qualified as a QF. Without QF status guaranteed as a result of Con Ed's being a thermal host of petitioner's facility, Mr. Trabold stated that the facility would never have been built.

33. Mr. Trabold stated that petitioner's contract with Con Ed allowed sales of electricity up to 315 megawatts, and upon cross examination, he agreed that petitioner is a cogeneration facility that had an electric generating capacity of more than 150 megawatts.

34. In reciting the facts in an Order Granting a Certificate of Public Convenience and Necessity under Public Service Law § 68 which authorized petitioner to sell electricity to BNYDC for use in its offices and the Brooklyn Navy Yard common areas, the Public Service Commission stated: "With respect to steam production and its operation as a QF, the partnership has existing contracts to supply steam to its steam hosts, Con Edison, BNYDC and the Red Hook Pollution Control Plant (Red Hook)."

Frank W. Radigan who was qualified at the hearing as an expert in New York State energy regulation (***see***, Finding of Fact "26"), stated that based upon his experience (15 years) with the Public Service Commission, it is his understanding that the language in the aforementioned order means that petitioner is a QF and that Con Ed, BNYDC and Red Hook are its thermal energy

hosts. It is the opinion of Mr. Radigan that Con Ed was a thermal host of petitioner's Brooklyn Navy Yard facility.

35. Professor Richard D. Pomp appeared at the hearing and testified on behalf of petitioner. Professor Pomp is a professor at the University of Connecticut Law School, New York University Law School and Columbia University Law School. He has testified on behalf of state governments and consulted with the U.S. Treasury, the Department of Justice, the Internal Revenue Service, the Multistate Tax Commission and numerous state and local governments. Professor Pomp has previously been qualified as an expert witness in three cases involving the taxation of gas and electricity. At the hearing, Professor Pomp was qualified as an expert in the field of energy tax policy.

Professor Pomp testified regarding the term "use" as it is applied in the context of tax policy throughout the country. He stated that many states have taxing statutes that depend upon whether the object of the tax is used. He indicated that the term "use" occurs where a right or power is exercised over property and, in his opinion, the selling of property is an exercise of a right or power over that property. Based upon his survey of the definition of "use" in various states' tax provisions as well as dictionary definitions, Professor Pomp concluded that a resale of property is a use of that property. Professor Pomp also opined that where a state wishes to exclude any type of resale from the definition of "use" it may do so expressly in the governing statute and that many states have determined to do so.

36. Professor Pomp, as an expert in the field of energy tax policy, indicated in his written opinion which was offered into evidence by petitioner, that PURPA required utilities to buy electric power from qualifying facilities under long-term contracts. These qualifying facilities were not owned by or contractually obligated to an established utility or power company.

PURPA undercut the power of the local utilities which were previously free to refuse to buy from non-utilities. Professor Pomp stated that the exemption provided in Tax Law § 189(former [6]) encouraged the growth of cogeneration and provided a tax advantage over competitors who were not cogenerators. In the opinion of Professor Pomp, the Division's interpretation of this exemption statute, i.e., to deny this exemption would increase the price of steam or electricity sold by a cogenerator under conditions not intended by the Legislature.

CONCLUSIONS OF LAW

A. The initial issue which must be addressed is whether a rational basis existed for the issuance of the notices of deficiency to petitioner by the Division. The primary basis for petitioner's contention that a rational basis did not exist in the present matter is the failure of the Division's witness, Laurence Albert, Tax Auditor III, to explain why the Division disallowed the exemption under Tax Law § 189 (former [6]) for petitioner's purchases of gas services used to generate electricity and steam which petitioner sold to Con Ed. Mr. Albert testified that he and the other members of the audit team advised petitioner's former representative that the question of whether petitioner qualified for the exemption would be referred to the Division's Office of Counsel. Subsequently, he was directed to issue a Notice of Deficiency (actually two notices were issued, one for a deficiency of tax pursuant to Tax Law § 189 and the other for a deficiency of the temporary metropolitan transportation tax surcharge pursuant to Tax Law § 189-a), but was uncertain as to who directed him to do so. Mr. Albert stated that he was not certain as to which elements of the exemption were allegedly not satisfied by petitioner. No other witnesses were provided by the Division to explain the basis for the determination by the Division that petitioner did not qualify for the exemption. While petitioner did not subpoena any of the other members of the audit team, it contends that it relied on the fact that the audit supervisor, Mr. Albert, would be

able to explain the basis upon which the claimed exemption was denied and Mr. Albert was not, in fact, able to do so.

In addition, petitioner maintains that the Division had no rational explanation for the fact that the exemption under Tax Law § 189 (former [6]) was allowed for purchases of gas services used to generate electricity and steam that was sold to BNYDC and Red Hook, but not for electricity and steam sold to Con Ed.

In response, the Division points to the fact that the audit focused on the exemption claimed with regard to petitioner's purchases of gas services used to generate electricity and steam sold to Con Ed since such sales constituted a substantial majority of petitioner's sales. Accordingly, in an attempt to conserve administrative resources, the exemption was allowed for purchases of gas services used to generate electricity and steam sold to BNYDC and Red Hook. Moreover, the Division argues that in its answer to the petition filed by petitioner, the Division affirmatively stated that sales of electricity or steam to an entity which resells such electricity or steam to the ultimate consumer do not fall within the exemption provided by Tax Law § 189 (former[6]).

B. As noted by the Tax Appeals Tribunal in ***Matter of Metzger*** (Tax Appeals Tribunal, February 11, 1993):

> [a] presumption of correctness attaches to an assessment issued by the Division which, in itself, provides the rational basis, so long as no evidence is introduced challenging the assessment (***Matter of Leogrande v. Tax Appeals Tribunal***, 187 AD2d 768, 589 NYS2d 383, ***leave denied*** 81 NY2d 704, 595 NYS2d 398; ***see, Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759, 431 NYS2d 174). Our cases establish that the Division has the obligation, in response to the petitioner's inquiry at the hearing, to describe the audit methodology used and that the method as described must be rational (***see***, ***Matter of Atlantic & Hudson Ltd. Partnership***, Tax Appeals Tribunal, January 30, 1992).

Citing ***Matter of Metzger*** (***supra***), the Tribunal stated that "[t]he Division does not have an affirmative burden to establish the rational basis for its assessment." (***Matter of Hemrajani***, Tax Appeals Tribunal, August 19, 1993).

Before considering the evidence introduced by petitioner which purports to challenge the validity of the notices of deficiency, it must be determined whether the Division was able to respond to petitioner's inquiries as to the audit methodology used in order that petitioner have the opportunity to prove, by clear and convincing evidence, that the ultimate deficiencies asserted or the method of asserting such deficiencies were erroneous or irrational (***see***, ***Matter of Giuliano v. Chu***, 135 AD2d 893, 521 NYS2d 883; ***Matter of Scarpulla v. State Tax Commn.,*** 120 AD2d 842, 502 NYS2d 113).

In the present matter, the basis for the issuance of the notices of deficiency was a determination by the Division that petitioner was not entitled to claim the exemption provided in Tax Law § 189 (former[6]). As previously noted, the Division, in its answer to the petition, affirmatively stated, among other things, that the electricity supplied by petitioner to Con Ed was not used by Con Ed within the meaning of Tax Law § 189 (former[6]) and that the sales of electricity or steam to an entity which resells such electricity or steam to the ultimate consumer do not fall within the exemption provided by such section.

As noted by the Division in its brief, statutes creating tax exemptions are to be strictly and narrowly construed and the petitioner has the burden of showing clear entitlement to the provision of law authorizing the exemption at issue (***see***, ***Matter of Lever v. New York State Tax Commn.***, 144 AD2d 751, 535 NYS2d 158, 160; ***Matter of Yankowitz v. Department of Taxation & Fin. of State of New York***, 140 AD2d 866, 528 NYS2d 906, 908).

In essence, this matter is not one in which an audit methodology needs scrutiny. The crux of the matter is that petitioner claimed entitlement to the exemption provided in Tax Law § 189 (former[6]) and the Division disallowed the exemption based primarily on its assertion that sales of electricity or steam to an entity (in this case, Con Ed) which resells such electricity or steam to the ultimate consumer do not fall within the exemption. Therefore, while the Division's witness at the hearing, Laurence Albert, Tax Auditor III, was unable to identify the Division employee who made the final determination that petitioner's sales to Con Ed did not qualify for the exemption, there was clearly no prejudice to petitioner who was previously made aware of the basis of the Division's disallowance of the claimed exemption. This lack of prejudice to petitioner is evident from the testimony and other evidence presented by petitioner's witnesses at the hearing, most notably that of Professor Richard D. Pomp who testified to and prepared a written opinion which dealt primarily with the meaning of the term "use" and whether such term would include "resale."

Accordingly, it must be found that a rational basis existed for the issuance of the notices of deficiency and petitioner's contention that such notices should be declared void is, therefore, denied.

C. "[T]o attempt to equalize the tax burden in relation to consumers of gas service," sections 189 and 189-a of the Tax Law were enacted in 1991. (L 1991, ch 166, § 149.) With the deregulation of the interstate natural gas market by Congress and FERC in the 1970s and 1980s and without the enactment of Tax Law § 189, consumers of gas services would have been able to avoid the burden of the taxes imposed by sections 186 and 186-a of the Tax Law by purchasing the service out of state and hiring transportation to carry that service to the consumer's premises

in New York State. As noted by the Court of Appeals of New York in ***Tennessee Gas Pipeline Co. v. Urbach*** (96 NY2d 124, 127, 726 NYS2d 350):

> Allowing industrial end users to bypass local utilities and purchase gas outside the State created a tax problem for New York. The State's system of natural gas taxation was developed prior to deregulation and focused on utilities and other entities that sold gas within New York. Section 186 of the Tax Law imposes a corporate franchise tax on any corporation, joint stock company or association 'formed for or principally engaged in the business of supplying water, steam or gas, when delivered through mains or pipes (Tax Law § 186[1]).

As stated in the "purpose clause" in the legislation which enacted Tax Law §§ 189 and 189-a:

> The legal incidence of the taxes imposed by sections 186 and 186-a of the tax law are on the utility making sales of gas services in this state. However, both of these taxes are presently passed through by the utility separately, and in their entirety, to consumers purchasing gas services from such utility in this state pursuant to rate regulation of the charge for such services by the public service commission. Thus, consumers of gas services purchased in this state from utilities bear the direct pass-through of both such taxes. . . . Accordingly, to insure continuing comparability, pursuant to regulation by the public service commission, utilities shall be required to continue to pass through the total amount of such taxes [the taxes imposed by sections 189 and 189-a] to in-state consumers so that such consumers will continue to bear the economic burden of such taxes (L 1991, ch 166, § 149).

Therefore, for taxable months commencing after August 1, 1991, Tax Law § 189(2)(a) imposed on every gas importer a monthly privilege tax "on the privilege or act of importing gas services or causing gas services to be imported into this state for its own use or consumption in this state." Tax Law § 189-a imposed a tax surcharge, in addition to the tax imposed by Tax Law § 189 on every gas importer importing or causing gas service to be imported into the State for its own use or consumption in the Metropolitan Commuter Transportation District.[5]

---

[5] Pursuant to Public Authorities Law § 1262, the Metropolitan Commuter Transportation District includes the City of New York and certain other counties. Since petitioner's facility is located in Brooklyn which is part of the City of New York, it is located within the Metropolitan Commuter Transportation District.

E. For the period at issue herein, Tax Law § 189 (former [6]) provided, in part, as follows:

> Exemption. The following quantities of gas service otherwise includable in the measure of the tax imposed by this section shall be exempt from the measure of such tax. Gas service sold to a cogeneration facility, as such term is defined in subdivision two-a of section two of the public service law, or a qualifying facility which is a cogeneration facility, as such term is defined by section two hundred one of the Public Utility Regulatory Policies Act of 1978 (Public Law 95-617), and used to generate electricity and/or steam produced by such facility when such electricity or steam is supplied and *used by* a thermal energy host located at or near the project site . . . . (Emphasis added.)

F. Before determining whether petitioner's sales to Con Ed for resale by Con Ed to its customers fall within the exemption provided in Tax Law § 189 (former [6]), it is first necessary to ascertain whether petitioner meets the other requirements of the statute, to wit: (a) Whether petitioner is a cogeneration facility as defined in Public Service Law § 2(2-a); (b) Whether petitioner is a qualifying facility (QF) which is a cogeneration facility; (c) During the period at issue, whether Con Ed was a thermal host of petitioner; and (d) If so, whether Con Ed was located "at or near the project site."

In its answer (in paragraph 9 thereof) and again, in its brief (p.10), the Division has admitted that petitioner is a cogeneration facility. However, Public Service Law § 2(2-a) defines the term "cogeneration facility" in relevant part as follows: "any facility with an electric generating capacity of up to eighty megawatts." As noted in Finding of Fact "33", petitioner had an electric generating capacity of more than 150 megawatts (its contract with Con Ed permitted sales of electricity up to 315 megawatts). Therefore, while petitioner is admittedly a cogeneration facility, since it had an electric generating capacity greater than 80 megawatts, it would not qualify for the exemption under Tax Law § 189 (former [6]) unless it was found to have been "a qualifying facility which is a cogeneration facility, as such term is defined by

section two hundred one of the Public Utility Regulatory Policies Act of 1978 (Public Law 95-617)."

G. In its petition, petitioner alleged (and in its answer, the Division admitted that "[t]he Facility is approved by the Federal Energy Regulatory Commission to operate as a Qualified Facility as such term is defined in section 201 of the Public Utility Regulatory Policies Act of 1978 [Public Law 95-617])." However, in its brief, the Division contends that petitioner was not a QF until April 9, 1997, the date on which FERC granted petitioner's application for certification as a QF.

Petitioner maintains that while FERC denied its original application by an order issued January 17, 1996, such order stated that petitioner's facility satisfied FERC's operating and efficiency standards and petitioner's application (filed on August 16, 1995 and completed on October 19, 1995) was denied on the basis that it did not satisfy certain ownership criteria (***see***, Finding of Fact "8"). Petitioner contends that the partnership agreement was then amended so that the ownership requirements were met and petitioner filed a self-certification within several weeks thereafter. Therefore, petitioner states that when it filed its original application in 1995, it was a QF.

Petitioner's position is without merit. It is clear from the orders of FERC that in order to be a QF, it is necessary for the facility to satisfy the operating and efficiency standards as well as the ownership criteria. Petitioner, while meeting the operating and efficiency standards, did not meet the ownership criteria thereby necessitating a second application for QF status which status was granted on April 9, 1997. Accordingly, even if it is hereinafter determined that petitioner was entitled to the exemption provided in Tax Law§ 189 (former [6]), such exemption would be applicable not for the entire period at issue (December 1, 1996 through November 30, 1999) but would be applicable only for the period April 9, 1997 through November 30, 1999.

H. There is no definition of the term "thermal energy host" in either the Tax Law or the Public Service Law. The Division's audit team did not analyze whether Con Ed was a thermal host (***see***, Finding of Fact "16"). Therefore, in determining whether Con Ed was a "thermal energy host," it is reasonable to look to those who are most familiar with the term.

William A. Harkins, a long-time employee of Con Ed who served as vice president in charge of energy management and planning and who executed the Energy Sales Agreement between Con Ed and petitioner, was familiar with the term "thermal host" which he stated was an entity that is located in close proximity to a cogeneration facility and which has the ability to use the thermal output (the steam) or some of the thermal output of that cogeneration facility.

Christopher Trabold, petitioner's executive director, indicated that all cogeneration facilities have thermal hosts and that Con Ed was the single largest thermal energy host of petitioner's facility. He also stated that BNYDC and Red Hook were thermal energy hosts of petitioner. Mr. Trabold also acknowledged that if Con Ed was not a thermal host of petitioner, then petitioner would not have qualified as a QF since its sales of steam to Con Ed could not have been included in its calculations for purposes of attaining QF status.

Frank W. Radigan, who was qualified at the hearing as an expert in New York State energy regulation, was employed by the Public Service Commission for 15 years. He was assigned to handle all PURPA matters relating to qualifying facilities including the implementation of regulations. Mr. Radigan indicated that he was familiar with term "thermal energy host" and that, in his opinion, Con Ed was a thermal energy host of petitioner.

Based upon the opinions of the above-named witnesses who were familiar with the term "thermal energy host" and with the relationship between petitioner and Con Ed, it is hereby found that Con Ed was a thermal energy host of petitioner during the period at issue.

I. Having found that Con Ed was a thermal energy host of petitioner, it must then be determined whether Con Ed was located "at or near the project site" as provided in Tax Law § 189 (former [6]). As was the case with determining whether Con Ed was a thermal energy host of petitioner, the Division's auditors did not analyze whether Con Ed was located at or near petitioner's cogeneration site. Accordingly, it is again reasonable to turn to those most familiar with the terminology "at or near" and with the physical location of both petitioner's facility and Con Ed.

Con Ed owns a steam and electric generating facility known as its Hudson Avenue Plant. The steam and electricity sold by petitioner to Con Ed is delivered to the Hudson Avenue Plant. Petitioner's facility at the Brooklyn Navy Yard is located within 2,000 feet of the Hudson Avenue Plant if the distance is measured directly.

Steam leaves petitioner's facility and travels above ground to the Hudson Avenue Plant with ownership of the steam transferring at a metering station just past the fence separating Con Ed's property from the property of petitioner. Following the steam line from petitioner's facility to the Hudson Avenue Plant results in a measurement of 3,250 feet.

Electricity travels from petitioner's facility, mostly underground, to the substation at the Hudson Avenue Plant. Following the electricity from petitioner's Brooklyn Navy Yard facility to the Hudson Avenue Plant results in a measurement of 2,950 feet.

Frank W. Radigan, who was qualified at the hearing as an expert in New York State energy regulation and who was employed by the Public Service Commission for 15 years and was on a team that was specifically assigned to handle all PURPA matters relating to qualifying facilities, explained that "at or near" is not a statutorily defined term and, as a result, the Public Service Commission has ruled on this issue on a case-by-case basis. Mr. Radigan indicated that

he was not aware of any rulings by the Public Service Commission where a distance of less than one mile was not considered to be "at or near" a facility. In his opinion, petitioner's Brooklyn Navy Yard facility and Con Ed's Hudson Avenue Plant are the "exact definition of at or near" and he described the location of these facilities as "just a throw over the fence."

Margaret A. Moore, an attorney who was qualified at the hearing as an expert in the field of Federal Energy regulation explained that under FERC rules, the term "same site" is used regarding the aggregation of capacity of facilities and that FERC considers facilities as being on the same site if they are located within one mile of each other. In Ms. Moore's opinion, petitioner's facility and Con Ed's Hudson Avenue Plant would be considered to be located at the same site under the rules of FERC.

William A. Harkins, Con Ed's former vice president in charge of energy management and planning who executed the Energy Sales Agreement between Con Ed and petitioner, indicated that he was familiar with the term "at or near" and was also familiar with the location of both petitioner's Brooklyn Navy Yard facility and Con Ed's Hudson Avenue Plant. Mr. Harkins described petitioner's facility as being "very close" to the Hudson Avenue Plant and stated that the facility was "in the backyard" of the Hudson Avenue Plant.

A review of the evidence presented herein, including photographs of the facilities as well as the testimony of the above individuals who are familiar with both facilities as well as the physical locations thereof, results in a determination that, for purposes of the exemption from tax provided by Tax Law § 189(former [6]), Con Ed's Hudson Avenue Plant was a thermal energy host located at or near the project site.

J. Having heretofore concluded that petitioner's Brooklyn Navy Yard facility was, for the period April 9, 1997 through November 30, 1999, a qualifying facility which is a cogeneration

facility as defined by PURPA used to generate electricity and steam supplied to a thermal energy host located at or near the project site, it must now be determined whether the electricity and steam were "used by" the thermal energy host (Con Ed) so as to qualify petitioner's sales of the electricity and steam to Con Ed for the exemption from tax as provided in Tax Law § 189(former [6]). The term "used by" is not defined in Article 9 or Article 9-A of the Tax Law.

Statutes creating a tax exemption are to be strictly and narrowly construed (***Matter of Mobil Oil Corp. v. Finance Administration of City of New York,*** 58 NY2d 95, 98, 459 NYS2d 566; ***Matter of Grace v. New York State Tax Commn.***, 37 NY2d 193, 195, 371 NYS2d 715). The burden of proving entitlement to a tax exemption rests with the taxpayer (***Matter of Blue Spruce Farms v. New York State Tax Commn.***, 99 AD2d 867, 472 NYS2d 744 ***affd*** 64 NY2d 682, 485 NYS2d 526; ***Matter of Young v. Bragalini***, 3 NY2d 602, 170 NYS2d 805). To prevail over the construction by the administrative agency charged with its enforcement, the taxpayer must establish not only that its interpretation of the law is a plausible one, but, also, that its interpretation is the only reasonable construction (***Matter of Blue Spruce Farms v. New York State Tax Commn., supra***).

K. Petitioner contends that "use" is a broadly utilized term in state taxation statutes throughout the country and generally refers to any exercise of power or control over property. Therefore, Con Ed's resale of the electricity and steam which it purchased from petitioner is an exercise of power or control over the electricity and steam. Petitioner alleges that if the State Legislature intended to exclude a resale from constituting a use, it could have done so specifically by statute. In Tax Law § 189(former [6]), petitioner asserts that no such limitation exists. These are the conclusions of Professor Richard D. Pomp who was qualified at the hearing as an expert in the field of energy tax policy (***see***, Finding of Fact "35"). Petitioner also

maintains that the exemption from tax provided by Tax Law § 189(former [6]) furthers the intent of PURPA which was enacted to reduce this country's reliance on foreign fossil fuels. By subjecting cogeneration facilities such as petitioner to the tax imposed by Tax Law § 189, the State would be thwarting the policy of PURPA which was to foster the development of cogeneration projects.

In response, the Division states that Tax Law § 189 was enacted to equalize New York's tax burden on natural gas consumed in the State regardless of whether it was purchased inside the State (whereby it would be subject to tax under Tax Law §§ 186 and 186-a) or purchased outside the State and thereafter brought to New York (whereby it would be subject to tax under Tax Law §§ 189 and 189-a). The Legislature, recognizing that the taxes imposed by Tax Law §§ 186 and 186-a were passed through to the ultimate gas purchasers who purchased the gas from utilities pursuant to regulation by the Public Service Commission, required that the taxes imposed by Tax Law §§ 189 and 189-a would also be passed through to the in-state consumers thereby creating a comparable economic burden on these consumers (L 1991, ch 166, § 149). The Division contends that to exempt the sales of electricity and steam by petitioner to Con Ed would defeat the compensatory tax structure created by the enactment of the natural gas import taxes since such taxes would create an unfair advantage for a public utility such as Con Ed, to wit, Con Ed could sell the electricity and steam to its customers at a lower rate since the tax would not be passed on to the customers, or Con Ed could charge an amount reflecting a reimbursement of petitioner for the amount of section 189 tax and then retain this amount as a windfall profit since, pursuant to the exemption, no tax would be due.

The Division, citing 20 NYCRR 45.9,[6] further asserts that sales for resale, as distinguished from sales for consumption, are explicitly excluded from taxation under Tax Law § 186. 20 NYCRR 45.9 states that "[r]eceipts from sales or services for ultimate consumption or use by the purchaser in this State are taxable, but receipts from sales for resale, as distinguished from sales for consumption, are not taxable." Under the compensatory tax structure created by New York State through the enactment of the natural gas import tax (Tax Law § 189), the Division maintains that it follows that the tax imposed by Tax Law § 189 was never intended to apply to sales for resale. Therefore, contends the Division, petitioner's assertion that a tax which is not imposed on sales for resale would contain an exemption from tax for gas used to generate steam and electricity sold for resale makes little sense.

The Division notes that the exemption provided by Tax Law § 189(former [6]) applies to "gas service sold to . . . a qualifying facility which is a cogeneration facility . . . and used to generate electricity and/or steam produced by such facility when such electricity or steam is supplied and *used by* a thermal energy host located at or near the project site" (emphasis added). It is the Division's position that if resale is to be included in the meaning of the term "use," the word "by" has no meaning. The word "by" indicates that the thermal energy host is the instrumentality of the use; therefore, the thermal energy host must itself use the electricity or steam, rather than reselling it. Electricity or steam must be supplied to and used by a thermal energy host to trigger the exemption. The Division argues that using petitioner's analysis, the qualifying facility need only supply steam and electricity to a thermal host to trigger the exemption.

---

[6] Petitioner contends that this regulation applies only to the tax imposed by Tax Law § 186-a, and not to the tax imposed by Tax Law § 186. Since the section 186-a tax makes specific reference to "ultimate consumption or use by the purchaser" and the section 186 tax does not, it is apparent that petitioner is correct in its assertion that 20 NYCRR 45.9(a) applies to the section 186-a tax only.

L. Tax Law § 189(2)(a) provides as follows:

> General. For taxable months commencing on and after August first, nineteen hundred ninety-one, there is hereby imposed on every gas importer a monthly privilege tax for all or any part of a taxable month on the privilege or act of importing gas services or causing gas services to be imported into this state *for its own use or consumption* in this state (emphasis added).

During the period at issue herein, the term "gas importer" was defined in Tax Law § 189(1)(former [b]) as follows:

> The term 'gas importer' means every person who imports or causes to be imported into this state services which have been purchased outside the state *for its own use or consumption* in this state, provided such term does not include a public utility subject to the jurisdiction of the public service commission as to the matter of rates on sales to customers (emphasis added).

From a reading of the statute imposing the section 189 tax, it is apparent that the tax is imposed on a gas importer when such importer purchases gas services outside the State *for its own use or consumption in this State.* It is undisputed that petitioner used or consumed these gas services to produce electricity and steam which it then sold to Con Ed and to BNYDC and Red Hook. Absent any exemption from tax, it is clear that petitioner would owe section 189 tax on its purchases of the gas services.

As previously noted (***see***, Conclusion of Law "J"), the section 189 tax was enacted to equalize New York's tax burden on natural gas consumed in the State regardless of whether it was purchased inside or outside the State. In furtherance of this purpose, the Legislature required that the section 189 tax (and the section 189-a surcharge) be passed through to in-State consumers just as the section 186 and 186-a taxes were passed through to the ultimate gas purchasers. The Division argues that to exempt the sales of electricity and steam by petitioner to Con Ed would defeat the compensatory tax structure intended by the Legislature since it would

create an unfair advantage for a public utility such as Con Ed. Petitioner, on the other hand, states that its interpretation of the exemption statute furthers the intent of PURPA which was to encourage the use of qualifying facilities.

M. A careful consideration of the arguments of petitioner and the Division reveals considerable merit in both. However, it appears that the Division's primary argument against granting the exemption to petitioner is not so much its objection to a cogeneration facility which is a qualifying facility such as petitioner receiving an exemption from tax as it is its apprehension over a potential inequity which might ultimately result therefrom, to wit, the customers of Con Ed who might reap the benefit of purchasing electricity or steam at a rate which would not include the section 189 tax. That is to say, if the thermal hosts of petitioner located at or near the project site did not include a public utility such as Con Ed, it seems unlikely that the Division would deny this exemption to petitioner.

This is not to say that the Division's concern with Con Ed being able to sell its electricity and steam at a lower rate than other public utilities is without merit. In 1999, the Legislature chose to amend Tax Law § 189 (former [6]) as follows:[7]

> (b) Gas service used to generate electricity for sale. Such exempt gas service shall not include, however, gas service sold to a cogeneration facility, such as the term is defined in subdivision two-a of section two of the public service law, or a qualifying facility which is a cogeneration facility, as such term is defined by section two hundred one of the Public Utility Regulatory Policies Act of 1978 (Public Law 95-617), and used to generate electricity for sale to a public utility subject to the jurisdiction of the public service commission as to the matter of rates on sales to customers.

[7] Chapter 407 of the Laws of 1999 amended subdivision 6 of section 189 of the Tax Law by expanding the previous exemption. The exemption, as set forth prior to this amendment, became paragraph (a) and a new paragraph (b) was added. For purposes of brevity, only the provisions of paragraph (b) are set forth herein.

Therefore, pursuant to this amendment, for taxable months commencing on or after January 1, 2001, gas used to generate electricity (but not steam) which is sold to a public utility (such as Con Ed) is no longer exempt from the section 189 tax. Since the Legislature enacted legislation which affirmatively removed this exemption from the section 189 tax, it is reasonable to conclude that, prior to this amendment, the Legislature and the Division were aware that section 189(former [6]) permitted just the exemption from tax as is at issue herein.

Petitioner's argument is further buttressed by the statute which imposes the section 189 tax. As previously noted (***see***, Conclusion of Law "L"), section 189(2)(a) contains specific language imposing tax upon a gas importer who imports gas services into this State "for its own use or consumption in this state." Moreover, the definition of "gas importer" refers to gas services which have been purchased outside the State "for its own use or consumption in this state." The term "for its own use or consumption in this state" were contained in the original section 189 statutes enacted in 1991 (L 1991, ch 166). Had it been the intent of the Legislature that the exemption set forth in Tax Law § 189 (former [6]) be limited to electricity or steam supplied and used by the thermal energy host *for its own use or consumption*, it certainly would have been reasonable and prudent for such language to have been added to the exemption provision since it had already been included in other subdivisions of section 189.

The Division's arguments against the applicability of the exemption from the section 189 tax for petitioner's sales of electricity and steam to Con Ed because Con Ed then resold the electricity and steam to its retail customers, while allegedly concerned with the compensatory tax concept, i.e., the equal treatment of taxation of natural gas whether purchased inside or outside the State, is really focused on the potential for a competitive advantage which could result from a public utility such as Con Ed purchasing electricity and steam from a cogeneration facility

without having the section 189 tax passed through to it. As previously noted, the Legislature, in 1999, addressed this issue and amended the statute accordingly.

Clearly, therefore, petitioner's interpretation of Tax Law § 189 (former [6]) is the only reasonable construction of the statute and, accordingly, petitioner has proven its entitlement to the exemption provided therein.

N. The Division's position concerning the applicability of section 189 to sales for resale, while quite confusing, must also be addressed. In its brief, the Division states that while section 189 does not explicitly exclude sales for resale (because it was designed to tax those entities which could escape taxation under sections 186 and 186-a when deregulation made it possible to purchase gas outside the State for consumption within the State), it states that section 189 was never intended to apply to sales for resale. While it is true that section 189 does not apply to sales for resale because it is imposed on the privilege or act of importing gas services or causing gas services to be imported into the State "for its own use or consumption in this State," it is difficult to understand the relevance to the facts at issue in this matter. At this point, it should be noted that Tax Law § 186-a imposes a tax on the furnishing of utility services including, but not limited to, persons selling gas, electricity and steam. The tax is imposed on "gross income" and "gross operating income" which terms are defined, in relevant part, as receipts from any sale "for ultimate consumption or use by the purchaser" in this State (Tax Law § 186-a[2][c], [d]). This or similar language requiring consumption or use by the purchaser is absent from Tax Law § 189(former [6]).

Although a sale for resale is involved since Con Ed is purchasing electricity and steam from petitioner for resale to Con Ed's retail customers, there is no resale of the gas or gas services which are the subject of the section 189 tax. Therefore, the issue of resale is really not

relevant to the applicability of the section 189 tax; instead, "resale" is relevant only as to the issue of whether a resale can be found to be a use by the thermal energy host, i.e., Con Ed. As Professor Pomp opined, most States define the term "use" in its taxing statutes as an exercise of any right or power over tangible personal property by the purchaser. Clearly, once the purchaser takes possession of the tangible personal property, it may do one of a number of things to the property including reselling it. Had it been intended by the Legislature to exclude a resale of the steam or electricity from the provisions of the exemption under Tax Law § 189(former [6]), it would have been reasonable to have included the same language as was included in other subdivisions of section 189, to wit, "for its own use or consumption in this state." Since the Legislature did not include this language when it enacted the statute, the Division cannot do so now.

O. As stated by the Tax Appeals Tribunal in ***Matter of Finch, Pruyn & Co., Inc.*** (Tax Appeals Tribunal, April 22, 2004), "the arguments that the gas import tax is constitutionally invalid on its face because it discriminates against interstate commerce in violation of the Commerce Clause is not a matter for decision within the purview of the Tax Appeals Tribunal and the Division of Tax Appeals.

P. As indicated in Conclusion of Law "G," petitioner did not meet the ownership criteria for QF status until April 9, 1997 and, accordingly, petitioner was not entitled to the exemption set forth in Tax Law § 189(former [6]) until such date. As a result, the tax, plus interest, for the period December 1, 1996 through April 8, 1997 is sustained and, for the period April 9, 1997 through November 30, 1999, the tax plus interest asserted to be due in the notices of deficiency issued May 28, 2002 is hereby canceled.

Q. The petition of Brooklyn Navy Yard Cogeneration Partners, L.P. is granted to the extent indicated in Conclusion of Law "P;" the Division of Taxation is hereby directed to modify the notices of deficiency issued May 28, 2002 accordingly; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York
September 9, 2004

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE